

Minutes from Federal Gas Rule Workshop Albuquerque, New Mexico April 24, 2003

A Federal Register Notice dated Thursday, April 10, 2003, announced that the Minerals Management Service (MMS) would hold four public workshops to discuss specific issues regarding the existing Federal gas royalty valuation regulations at 30 CFR Part 206 for natural gas produced from Federal leases.

Fourteen people attended the Albuquerque workshop and represented 3 companies, 2 States and 2 Tribes.

Opening Statements

Debbie Gibbs Tschudy introduced the panel members and welcomed the participants. This is the 2nd of 4 workshops to be held around the country.

The purpose of the current Federal gas rule is to ensure that the public receives a fair return on Federal resources. MMS believes the rule accomplishes this goal. However, we continually evaluate the effectiveness and efficiency of our rules. The existing rule is now 15 years old. With the changes in the natural gas market, our experience with the 2000 Indian gas rule, and 5 years of taking gas in kind, we are reevaluating the rule and asking for public input from our constituents.

We seek comments on the following issues:

- Should we simplify the current benchmark system for non-arm's-length sales? Should we allow lessees who sell production to an affiliate a 2-year option (similar to the oil rule) to base royalty value on either a published index for natural gas or their affiliate's arm's-length resale?
- Should we consider using NYMEX prices at Henry Hub in place of, or in addition to, published index prices?
- How should we adjust index prices for location differences?
- Are there pipeline charges since MMS' 1998 amendment to the gas transportation allowance regulations for which MMS should provide clarification on whether they are allowable?
- Should MMS adjust the allowable rate of return for calculating non-arm's-length transportation allowances?
- Should MMS allow lessees to apply an index price to wellhead volumes to eliminate the requirement of tracing processed gas to remove liquids?
- Should MMS clarify valuation under joint operating agreements (JOA)?

Affiliate Sales

Question: Should MMS modify the benchmark system?

State Comment:

- What is MMS' experience as it relates to these issues? Will this affect natural gas processing or sales in the Permian and San Juan basins?

MMS Comment: The Indian gas rule uses a formula in index areas, there is certainty in compliance and we have seen benefits. For RIK (almost exclusively in the Gulf) market offers are index based, offers for NYMEX were not successful (we did not receive best price and did not take those offers). Generally, index offers were based on the first of the month Bid price, and Gas Daily indexes. We are generally getting "index plus" with RIK sales. We see offers as index-based, and sales are mostly at or near the lease for unprocessed gas.

MMS Question: What is your current experience with the benchmarks?

State Comments:

- More companies are tracing price back to the property, comparing to index, paying royalties based on that. Larger companies are getting away from affiliate sales, may not see benefits of affiliate sale.

Industry Comments:

- The Indian rule does provide more certainty.
- More companies are not selling non-arm's-length because of tracing. It was not the intent of the regulations to cause companies to change the way they do business, but litigation and the expense of tracing caused companies to use arm's-length sales as least resistance. However, this is not the companies' preference.
- In the past, royalty has not driven decisions, but now the royalty is driving how companies do business, especially due to qui tam. Companies make business changes based on royalty issues alone.

State Comment:

- Is MMS taking any action with FERC over the index controversy?

MMS Comment: MMS has an internal report on validity of index reporting and what our exposure is on this issue. Our concern is about inflated value of the California border index, which may be higher than expected. Over time there are allegations that index is underreported in other ways. Are there concerns about whether index is it transparent enough? The Royalty Policy Committee (RPC) thinks it is broken and need fixing. MMS representatives are attending the FERC conference today.

State Comments:

- We see less of producers selling to an affiliate and transporting gas to California. Now, end users are coming to New Mexico to buy gas, this may be why there is more confidence in index.
- For any changes to the current benchmark system, is revenue neutrality an issue?

MMS Comment: Yes, under the Regulatory Flexibility Act, we are required to conduct a cost/benefit analysis for any proposed rulemaking showing the costs and benefits for industry, the Federal Government, and State and local governments.

State Comment:

- After the past gas regulation negotiation committee finished their report, MMS said the method was not revenue neutral, what has changed from 1997?

MMS Comment: We are holding these workshops to see if changes have occurred in the marketplace since the committee report was published. We are accepting comments on whether constituents think the rules are broken and need fixing.

State Comment:

- Royalty recipients feel the 1999 Texaco decision says rule is not broken. This decision says a lessee must pay on the higher of its affiliate's arm's-length gross proceeds or the benchmarks.

Industry Comment:

- Personally, believes that gas marketing is in a state of flux, especially after major marketers disclosed wrongdoing. Don't think the industry has settled into routine business. Platt's will need to do additional analysis. The government should not be involved. Platt's must validate that information collected is a true transaction, not a paper transaction. From a company

standpoint, we continue to sell on index, the index should truly reflect market not what a company thinks it should be. Our company representatives are at FERC today and will be at the Houston workshop. We would like to address specific indexes and caution what the government should designate. We believe this should be self policing, without government interference.

State Comment:

- Currently there is so much uncertainty about the index, the State is uncomfortable with using index. Platt's shouldn't dictate the value of gas. Gas is different than oil, gas from the San Juan Basin moves east or west. Leases could undervalue production by using the wrong index. We are very concerned about index.

Industry Comment:

- We echo the comment that industry/ index should be self policing, but indexes need to be a reliable key. If fraudulent, everyone suffers, but reliable indexes must be available.

Question: For producers with non-arm's-length sales that are applying the benchmarks, are you using index as value under the benchmarks? When you sell to your affiliate and apply the benchmarks, where do you end up?

Industry Comments:

- We no longer have affiliate sales, one reason is because we don't want to trace. We now have to market our own gas because of marketer failure. We asked ourselves if our marketer should be a department or a separate entity. We looked at federal and state regulations to determine whether to make a marketing affiliate a separate department or not. This business decision is new because of royalty implications, not business and tax implications.
- Our company looked through our affiliate sale to the affiliate's resale.
- Our company uses spot prices in the second benchmark (most of the time we use index as benchmark value).
- The benchmarks are different than index, but when applying the benchmarks, we end up using index (spot price) under the 2nd benchmark.
- For non-arm's-length sales, we use spot price, or spot price plus a penny, others pay on their affiliate's gross proceeds (even though this is complicated). So, lessee's affiliate value is probably equal to the 2nd benchmark, but depends on the company.

State Comment:

- It seems if everyone is going to index, they are not establishing a price. Index reflects bulk sales, the small guy sales aren't represented. There isn't a liquid enough price at some index points. Publications try to have 30% at cash sales before reporting. For various market participants, the first sale is not the last trade of the gas (utilities do not buy in the basin) but are cash sales by marketers that are being reported.

Industry Comments:

- One publisher of indexes had 80+ pricing points in December. By February, they published only 8 points and in March only 6. For the recent months, our company was not sure Platt's had fixed their issues. We didn't have an index to calculate prices so we wrote letters telling our royalty owners how we estimated prices for that month. Royalty owners were confused.
- The problem is not that deals weren't done on index, but that reporting may not have been correct. Gas must move, and index is the industry standard. The problem is that industry no longer has faith in index reports. Maybe Platt's doesn't have faith either, to go from 80 to 6 indexes.
- Those that misreported are now under federal indictment, so many companies are reluctant to report their transactions to the publications.

- In this situation, if MMS allowed companies an election, companies would just estimate a price and negotiate a contract retroactively because they had no sales on which to base royalties.
- Given the time that it takes a rule to get from start to final, by the time the rule is effective index will be fixed. Index will probably be fixed in the next 4 months.

Question: Why is one company not okay with index when others in Denver expressed confidence that the index would work?

Comments:

- Our company is finding our own downstream purchasers and we are carrying the ball. We advocate that index be an honest, actual, true movement of gas. We have to base value on something and until now that something has been index.

State Comment:

- Seems like there is an abrogation of buyer and seller if the parties just use index. Where is the negotiation that ensures that the deal is done in best way?

MMS Comment: Deals are started with index, than negotiated from that point.

State Comment:

- We're troubled that people just settle on index without negotiation.

Industry Comment:

- This phenomenon may stem from regulated era when companies just got regulated price. When regulated prices went away, long term contracts made people uncomfortable. Companies wanted something that will float on a month to month basis. You either pick something that floats, or do cash deals every month. Monthly cash deals are expensive, and you don't know flow from month to month.
- FERC 636 changed the environment. Separating the purchase from the sale made a business difference, now sellers have to get their own transportation and were not allowed to own their own pipeline. This changed how gas is marketed.

Question: If producers were selling to partially owned affiliates, did they end up using index?

Industry Comments:

- Yes, we think so.
- Joint venture marketers negotiated with buyers just like any other company.

Question: Assuming that index problems are eventually fixed, is the concept valid to apply to federal gas?

State Comment:

- MMS should codify the Texaco decision.

MMS Comment: What about production that is ultimately not sold? We need some way to value "no sale" situations.

State Comment:

- Throw out the 1st benchmark, make the 2nd benchmark the higher of gross proceeds or index. This modifies the rule to conform to the Texaco decision and makes the rule simple to apply. There is a lot of precedence from decisions on the '88 rule, why change? These decisions seem to say the '88 rule is okay.

Question: In Denver, a company made the statement that gas companies have already set up their systems to do gross proceeds comparisons. Would they have to modify their current system and do more work if they had the option to pay on index or gross proceeds?

State Comment:

- My observation is that companies are already set up to do gross proceeds comparisons.

Industry Comments:

- Setting up systems to perform a comparison would be a burden. In general company systems are not set up to do a comparison automatically, this would require manual work.
- Within their system, companies have the ability to pay each individual owner, by formula; not to compare index to gross proceeds. This must be done offline. System only does a comparison downstream for Indians. And, why specify the higher of gross proceeds or index if affiliates sales are gross proceeds?

State Comment:

- The current rules specify using the benchmarks, which is a combination of many factors, but never less than gross proceeds. Under the Texaco decision, gross proceeds are defined as the affiliate's resale.

Industry Comment:

- Why set up the system to compare? You know the arm's-length prices so you can say your non-arm's-length sale meets 1st benchmark.

State Comment:

- Current regulations require a comparison of the two in the case of a wholly-owned affiliate. Should be doing that now under the benchmark.

MMS Comment: When applying the 2nd benchmark, companies look to spot sales. The rule currently requires consideration of other relevant information. Other companies apply the 1st benchmark by knowing arm's-length sales.

Industry Comment:

- Both the gross proceeds and the reasonable comparison factors are applied on a case by case basis. When companies apply the factors, they seem to end up at an index. Why not give the choice between gross proceeds and index vs. use of "the higher of".

Use NYMEX in addition to, or instead of, Index (spot) Prices

Question: If MMS were to use NYMEX, how should we calculate location differential? At the Denver workshop, the discussion was that we look at the basis differential, but this method just ends up back at index, so how does this gain us anything? Index takes into account NYMEX basis differential so Denver participants saw no benefit to going to NYMEX. For MMS' RIK program, any bidding using NYMEX prices ended up lower, so no contracts were let by MMS RIK using NYMEX.

Comments:

No one had any additional thoughts on NYMEX issue.

Adjust Index for Location Differences

Question: If you physically flow to an index point, should the location differential remain the actual arm's-length rate paid or the calculated actual costs for non-arm's-length transportation? What should be used when you use an index point for value when you don't flow to that index?

State Comment:

- This is not a problem in the San Juan Basin on the El Paso, Transwestern, or Williams pipelines.

MMS Comment: What about flow to the east? Is there any?

State Comments:

- Index doesn't generally reflect those sales. It usually only recognizes flow west to California or Arizona. Don't know this for a fact but believe this is how index works in San Juan Basin.
- Don't know who trades going east, or how price is determined.

Industry Comments:

- Physical flow is recognized because people are competing for gas.
- You have to look at the marketplace of contracts that do flow to get information, this is difficult. Do you make contacts? Make open offer to bid?
- The Royalty Task Force recommends a standard deduction (postage stamp rate). This would be sufficiently low to minimize windfall to companies, but would eliminate any controversy with MMS. However, a percentage is difficult to swallow. We would prefer a flat rate. What if gas goes from \$8 to \$22 in a month? A flat rate (i.e., 4 cents/MMBtu) is better because transportation costs don't fluctuate like prices do. The flat rate would not be by pricing point, but maybe should be by area, or maybe for lower Texas, mid-Texas, and the Gulf.

Question: What about production areas where there is no index? What if production is two mountain ranges away from index? What do you do? Example would be at Raton, would you use a Kansas index, or the Denver index?

State Comments:

- Should it be up to the lessee to determine index? We need more detailed meetings to discuss by region, what the appropriate index and transportation rate would be.
- What about split stream? This is a problem. Maybe industry should propose what to do in this situation.

Industry Comments:

- Industry would be willing to do that. Maybe use an average of indexes? That might not be unreasonable.
- What is the intent of an adjustment? Is it administrative? Tough to get an accurate adjustment if a company uses \$X off of index. Current rules are working well, what is the specific purpose to using a standard deduction.
- The adjustment is used to get value back to the lease.

Question: Oil uses exchange agreements, are there gas exchanges? Would that work? Is it common?

Industry Comment:

- Oil is either sold or exchanged, gas moves on physical system, and can be tracked to a specific location.

MMS Comment: As an example, gas from the Rockies can go to Chicago or Casper. What if company elects to use index at Opal and the gas goes to Chicago?

Industry Comment:

- Where gas actually goes is the most logical to use as an adjustment.

- Gas may sell at a price or an average of three indexes. Once off of your gathering lines, that gas can go anywhere. Using an average of indices works, but physical transportation is on one line that may not be any of the three indices.

Question: Is this easier or harder than gross proceeds?

Industry Comments:

- Easier if there are multiple pooling points, harder if there is a sale at the lease.
- Gas is sold under index at pooling points.
- Limitation of systems is specific to each company.

Question: Should there be a standard deduction?

Industry Comments:

- For ownership in a line, the company can gather actual costs, but rebooking is burdensome. Under a standard deduct, costs can be done immediately.
- A standard deduct would be easier.
- If MMS allows index, use a standard deduct for simplicity. The standard deduction would be conservative, not overly generous so it would work for industry and government.
- It's administratively burdensome to calculate actual cost. We would propose using this for both, no flow and flow to index. It is less of a burden, is an agreed upon amount, and there would be no appeals.

State Comment:

- If there were two parties, would they get the same standard rate?

Industry Comment:

- A standard rate, as a conservative amount, would do for both.

State Comment:

- But to make sure standard was less than actuals, you still have to calculate actual costs. Maybe do actual cost calculations every 5 years to compare.

Industry Comment:

- We don't envision something so complicated. MMS would calculate and publish the standard deduction and company would use it, especially if a company doesn't own the pipeline.

State Comment:

- Maybe provide the last 5 years' actual costs, MMS would use 80-90% for the new 5 year period.

Industry Comments:

- To calculate any standard deduction would be complicated, but applying it would be administratively easy.
- We already have big fights on coalbed methane over how much is transportation and how much is non-allowable. It would be easier to say "On Williams' system you get 8 cents".

State Comment:

- This discussion is about gas, it would also have to apply to liquids.

Apply Index to Wellhead Volume

Question: Should MMS allow companies to apply index to the wellhead volume, adjusted for MMBtu, in lieu of reporting gas as processed gas and liquids?

Industry Comments:

- This would result in huge administrative savings for large plants and eliminate rebooking for each processed stream.
- With numerous interconnects, we had to do 4-5 years of adjustments, requiring us to ask affiliate to track transportation invoices. This is major work for small costs.
- The current rules cause us to generate huge volumes of records, mostly done by hand. Actual costs is very time consuming and not as simple as going to a voucher. It requires lots of coordination, and after properties are sold, creates an incredible burden of manual adjustments.
- Companies favor allowing this option.

State Comment:

- This allows companies to pay on a flat rate index, but accounting for gas liquids yields a higher value. The price of liquids really changes value. Companies should not manipulate revenue gain or loss based on flat rate index.

Industry Comment:

- If this becomes an option, don't make it an "in-and-out" option. Make the election for a certain period. Over time, there will be losses and gains and will average out over a set minimum time.

State Comment:

- We have net proceeds leases, we don't think this would fulfill the trust responsibility. This needs further study.

Industry Comment:

- This proposal is a very significant change and would require a study of economic impact.

State Comment:

- How is this detailed in the Indian gas index rule?

MMS Comment: For Indian gas, if a lessee is in an index area, the lessee pays on an average of the highest indexes, minus 10% (which represents transportation). Then, the lessee can elect actual dual accounting or apply the "% bump" method, using the actual gas Btu factor and its ownership in the plant.

State Comments:

- The negotiated rulemaking team didn't think the processing allowance should be eliminated.
- There is concern that applying index to wellhead volumes for Federal leases will adversely affect the revenue impact.

Industry Comment:

- Make this an option on an area by area basis. On a company-wide basis, the company may gain and lose in different areas and would be revenue neutral overall.
- These comments suggest that this requires more study, but industry sees a lot of savings on administrative side for this option.

State Comment:

- Will anyone be able to apply index at the wellhead?

MMS Comment: Originally, we envisioned this being used by those with non-arm's-length sales. If they choose the index option, then they could apply this to their processed gas. We could also make this an option for arm's-length payors.

State Comment:

- No, we see a problem with this. The Permian Basin gas is mostly arm's-length percentage-of-proceeds (POP) contracts, this would have some negative impacts.

Industry Comment:

- By basin, you could recognize particular facts. We don't know the impact now, but should look closely at this.

State Comment:

- This would be a problem affecting the lease terms for private royalty owners. If you have to calculate actual costs for one group, and something else for others, then rule is not helpful. Consistency is important.

Industry Comment:

- Most private leases don't have this kind of detailed language in the lease.
- If you were to apply index, you must apply it to the wellhead MMBtu volumes. There should be more stringent requirements to test wellhead Btu accuracy. Should tests be done more frequently?

State Comment:

- We are talking about applying index minus an actual or standard deduction, index is not at lease. Does this mean that when we apply the wellhead MMBtu at the lease, there is no transportation allowance?

MMS Comment:

- Transportation is allowed. The benefit is not to calculate separate values for gas and liquids after processing.

State Comment:

- The higher the Btu, the more liquids. Liquids have value.

Industry Comment:

- With current gas prices high (5-6 dollars) industry doesn't want to process. When gas prices are low, older plants charge so much that companies lose money processing.

Allowable Transportation Costs

Question: Since the 1998 amendments to the gas rule to address FERC 636 costs, are there additional costs we need to clarify in the rule? The intent is not to rehash old costs already discussed, but only new charges.

Industry Comment:

- As discussed yesterday, COPAS did not enough time to develop a list transportation costs, but plans to meet and provide input.
- FERC 636 costs are downstream, not everyone incurs those charges.
- A lot of costs are at hubs, these costs need to be looked at to determine if they are allowable.
- Park and loan fees were mentioned in Denver, are these the same as scheduling fees?

Industry Comment:

- With the collapse of marketers, producers are now moving their own production. Pipelines are requiring these companies to post bonds or letters of credit. There are costs associated with the letter of credit.

State Comments:

- We are now seeing a “low volume fee” if the producer doesn’t transport enough volume. This might be a type of scheduling fee that is non-allowable.
- Companies may be entering balancing agreements, this may be the “park and loan” fees, which is storage, in part, and may be non-allowable.

Allowable Rate of Return for Calculating Non-Arm’s-Length Transportation

Question: Is the current 1 times the BBB rate still appropriate?

State Comment:

- We think it should be eliminated. On other public lands, when a company is granted a concession, they can’t claim a rate of return for that concession. When the company sells the concession, they recapture the depreciation through increased sales value of the property. This is not recaptured on the oil and gas facilities. Thus, the transportation rate taken in the past is too high, but no adjustments are made to the royalty owner.

Industry Comments:

- If MMS expects companies to calculate a rate on actual costs, this is a cost of doing business and the BBB rate is not adequate.
- This is a cost of capital, not a rate of return. The cost of capital is higher than BBB, so the rate should be higher.
- Perhaps MMS should look what FERC allows for the cost of capital, it exceeds the BBB rate.
- Rule should allow company to report its actual capital cost to acquire the pipeline, rather than the previous depreciation.

State Comments:

- Disagree. We see companies depreciate a pipeline for 15 years then sell to a new buyer. The new buyer acquires the pipeline and maybe the production unit and then values the pipeline at 3 times the value of the remaining depreciation. The company should not then be allowed to recalculate an allowance on the inflated value.
- A company that realizes a gain in value from the sale of a facility had less costs than they claimed under the previous transportation deduction. They are not required to go back and adjust the deduction they took, but the new company then claims an allowance based on a greater cost value.

Industry Comment:

- This issue needs to be looked at. If MMS uses market-based deductions (standard or postage stamp), then companies don’t have to make adjustments and it becomes a non-issue.

MMS Comment: This won’t be an issue if MMS requires everyone to use the standard deduction, but if companies are allowed to do actual costs if they wish, it is still an issue.

Industry Comment:

- This will also be an issue for the actual processing deduction.

MMS Comment: Is it more an offshore issue? In arm’s-length situations, the rate paid by the producer includes not only a return, but profit for the pipeline owner. Those under the non-arm’s-length rule complain that MMS does not allow them to deduct this profit, as they do for arm’s-length. We believe the owner gets a benefit so we have treated them differently.

Industry Comments:

- There is a real cost in having to make the investment so the rate of return is a way to recognize this.
- When the market fluctuates, the investment in the plant is still there even when it's not economical to process.
- For onshore pipelines, there is greater risk in health and safety issues to the owner than to producers that just put their gas in someone else's pipeline.

State Comment:

- Health and safety is covered under insurance.

Clarify Value Under JOA Contracts

Question: If a non-operator chooses not to take in kind, the operator sells the non-owner's volume under its own contract. When the operator's sale is non-arm's-length, should MMS presume that the non-operator's sale to the operator is non-arm's-length?

Industry Comments:

- The transaction with operator is arm's-length and should be treated as such.
- The non-operator receives what the operator pays them, regardless of the type of sale under which the operator sells the gas.

State Comment:

- The JOA is not a negotiated sales contract. The JOA is silent as to price, location, deductions, etc. Not in favor of saying it is an arm's-length sale.

Industry Comment:

- This issue affects small working interests that don't want or can't find their own market. It forces small interest owners to look for a market.

State Comment:

- Using the operator's sale assumes that the operator is getting fair market value and giving it to the non-operator. What if the sales price to the affiliate that is used to pay the non-operator is less than arm's-length sales price the affiliate receives?

Industry Comment:

- The non-operator has no idea how to pay or market. They may have just a small amount of gas that no one would want to handle so how does non-operator find a market?

State Comments:

- The rule is not clear. If the operator's sale is not arm's-length or contains other consideration, then JOA is questionable.
- Well worth the opportunity to clarify.

Other comments

- Is MMS looking at hedging prices? Is this appropriate?

MMS Comment: We have examined hedging. We concluded that hedging is not a sale of production. Whether it results in a gain or loss, it is not appropriate for MMS to "play" in this market. If a company is hedging, are they even interested in the monthly marketing, or getting the highest monthly price? Hedging is risk management, a company may buy/sell the hedge over and over, and a different part of company may be selling vs. hedging. MMS has no idea what the final hedged position reveals as value.

Tribal Comment:

- The Tribes feel the Indian rule is serving quite well and made life a lot easier. Does MMS feel any issue would impact Indian rule?

MMS comment: Yes, changes to any FERC 636 transportations costs and to the rate of return would affect value under the Indian rule in cases where lessees were not in an index zone. If additional concerns come out about the index prices based on the outcome of the FERC inquiry and index were to disappear, we would obviously want to change the Indian rule to make sure gas is properly valued. Under the current rule, Tribes can opt out of index if the index becomes a problem.

Industry Comment:

- Must we provide comments in writing? Will you evaluate other comments?

MMS Comment: We will evaluate any comments, but because we don't have formal proposal, comments are not required in writing by a specific date. If you wish to submit written comments, submit them to the individual listed in the Federal Register, Paul Kneuen.

Industry Comment:

- From an industry point of view, we appreciate opportunity to discuss, we all learn from these workshops.

State Comments:

- There are gray areas and other issues in the current regulations, specifically: compression and gathering. These items should be clarified.
- Is the current requirement for reporting keepwhole agreements still necessary in today's market? Is it truly doable by the payor? This is an issue in the San Juan Basin plants. It just pushes calculating processing costs to producers who have no information. Why require them to report processed gas and liquids?
- Payors don't have actual volumes, they can only use shrinkage factors to estimate.
- This becomes a circular argument, value ends up back at gross proceeds.

MMS Comment: This requirement is not in the regulations, but is in the handbook. Companies have asked for reporting exceptions. We will revisit this issue.

State Comment:

When is dual accounting for federal leases required?

MMS Comment: If the residue gas is sold non-arm's-length, a lessee must perform dual accounting.

State Comment:

- Under POP contracts, many lessees are completely ignoring the 66 2/3 limit and the minimum value. The POP rule needs to be clarified.

MMS Comment: The rule is clear, a lessee with an arm's-length POP contract is required to compare its gross proceeds to the minimum value (100% of the value of the residue gas). If a company is not following this rule, it is a compliance issue, not an issue with the rule.

Industry Comment:

- Is MMS going to redefine the definition of affiliate based on the National Mining Association decision?

MMS Comment: If we publish a new rule we will incorporate that decision into the definition of affiliate. We would also clarify firm demand in accordance with the decision resulting from the appeal of MMS' FERC 636 transportation rule.

State Comments:

- If the federal government shares in the risk, maybe the risk is higher than the BBB rate, and MMS might give a deduction, but MMS has a duty to protect the public interest. In good stewardship, investment grade rate of return is limited, and may not be appropriate, i.e. the steward may not be able to give full risk.
- In the common market, companies are free to accept any level of risk, but good stewardship is required by the steward, and high levels of risk are not appropriate.

End of workshop.